The Importance of Reputation and Standardization

Asymmetric information is also present in many other markets. Here are just a few examples:

- **Retail stores:** Will the store repair or allow you to return a defective product? The store knows more about its policy than you do.
- **Dealers of rare stamps, coins, books, and paintings:** Are the items real or counterfeit? The dealer knows much more about their authenticity than you do.
- **Roofers, plumbers, and electricians:** When a roofer repairs or renovates the roof of your house, do you climb up to check the quality of the work?
- **Restaurants:** How often do you go into the kitchen to check if the chef is using fresh ingredients and obeying health laws?

In all these cases, the seller knows much more about the quality of the product than the buyer does. Unless sellers can provide information about quality to buyers, low-quality goods and services will drive out high-quality ones, and there will be market failure. Sellers of high-quality goods and services, therefore, have a big incentive to convince consumers that their quality is indeed high. In the examples cited above, this task is performed largely by *reputation*. You shop at a particular store because it has a reputation for servicing its products; you hire particular roofers or plumbers because they have reputations for doing good work; you go to a particular restaurant because it has a reputation for using fresh ingredients and nobody you know has become sick after eating there. Amazon and other online vendors use another model to maintain their reputation. They allow customers to rate and comment on products. The rating and commenting feature reduces the lemons problem by giving customers more information and motivating vendors to uphold their end of the bargain.

Sometimes, however, it is impossible for a business to develop a reputation. For example, because most of the customers of highway diners or motels go there only once or infrequently, the businesses have no opportunity to develop reputations. How, then, can they deal with the lemons problem? One way is *standardization*. In your hometown, you may not prefer to eat regularly at McDonald's. But a McDonald's may look more attractive when you are driving along a highway and want to stop for lunch. Why? Because McDonald's provides a standardized product: The same ingredients are used and the same food is served in every McDonald's anywhere in the country. Who knows? Joe's Diner might serve better food, but at least you *know* exactly what you will be buying at McDonald's.

Guarantees and Warranties

We have stressed the role of signaling in labor markets, but it can also play an important role in many other markets in which there is asymmetric information. Consider the markets for such durable goods as televisions, stereos, cameras, and refrigerators. Many firms produce these items, but some brands are more dependable than others. If consumers could not tell which brands tend to be more dependable, the better brands could not be sold for higher prices. Firms that produce a higher-quality, more dependable product must therefore make consumers aware of this difference. But how can they do it in a convincing way? The answer is *guarantees and warranties*.

Guarantees and warranties effectively signal product quality because an extensive warranty is more costly for the producer of a low-quality item than for the producer of a high-quality item. The low-quality item is more likely to require servicing under the warranty, for which the producer will have to pay. In their own self-interest, therefore, producers of low-quality items will not offer extensive warranties. Thus consumers can correctly view extensive warranties as signals of high quality and will pay more for products that offer them.

EXAMPLE 17.3 WORKING INTO THE NIGHT

Job market signaling does not end when one is hired. Even after a few years of employment, a worker will still know more about his abilities than will the employer. This is especially true for workers in knowledge-based fields such as engineering, computer programming, finance, law, management, and consulting. Although an unusually talented computer programmer, for example, will be more skilled than his co-workers at writing programs that are efficient and bug-free, it may take several years before the firm fully recognizes this talent. Given this asymmetric information, what policy should employers use to determine promotions and salary increases? Can workers who are unusually talented and productive signal this fact and thereby receive earlier promotions and larger salary increases?

Workers can often signal talent and productivity *by working harder and longer hours*. Because more talented and productive workers tend to get more enjoyment and satisfaction from their jobs, it is less costly for them to send this signal than it is for

other workers. The signal is therefore strong: It conveys information. As a result, employers can—and do—rely on this signal when making promotion and salary decisions.

This signalling process has affected the way many people work. Rather than an hourly wage, knowledge-based workers are typically paid a fixed salary for a 35- or 40-hour week and do not receive overtime pay if they work additional hours. Yet such workers increasingly work well beyond their weekly schedules. Surveys by the U.S. Labor Department, for example, found that the percentage of all workers who toil 49 hours or more a week rose from 13 percent in 1976 to over 16 percent in 2011.[6] Many young lawyers, accountants, consultants, investment bankers, and computer programmers regularly work into the night and on weekends, putting in 60- or 70-hour weeks. Is it surprising that these people are working so hard? Not at all. They are trying to send signals that can greatly affect their careers.

Employers rely increasingly on the signaling value of long hours as rapid technological change makes it harder for them to find other ways of assessing workers' skills and productivity. A study of software engineers at the Xerox Corporation, for example, found that many people work into the night because they fear that otherwise their bosses will conclude that they are shirkers who choose the easiest assignments. As the bosses make clear, this fear is warranted: "We don't know how to assess the value of a knowledge worker in these new technologies," says one Xerox manager, "so we value those who work into the night."

As corporations become more reluctant to offer lifetime job security, and as competition for promotion intensifies, salaried workers feel more and more pressure to work long hours. If you find yourself working 60- or 70-hour weeks, look at the bright side—the signal you're sending is a strong one.[7]